



IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 26.02.2007

CORAM:

THE HONOURABLE MR.JUSTICE P.D.DINAKARAN  
and  
THE HONOURABLE MRS.JUSTICE CHITRA VENKATARAMAN

T.C. (Appeal) No.15 of 2004

Commissioner of Income Tax  
Madurai.

..

Appellant

versus

M/s.Balika Finance Co. Ltd.  
Madurai.

..

Respondent

PRAYER: Tax Case Appeal filed under Section 260A of the Income Tax Act, 1961, against the order dated 18.6.2003 in ITA No.234/Mds/95 on the file of the Income Tax Appellate Tribunal, Madras 'A' Bench against the letter dated 5.10.1994 in P.A.No.49-003-CV-0339 IT appeal No.833/93-94 from the Commissioner of Income Tax (Appeals I) and letter dated 22.10.1993 in P.A.NO.49-003-CV-0339/92-93/IT from the Deputy Commissioner of Income Tax special Range-I, Madurai- 625 001.

For appellant

: Mrs.Pushya Sitaraman  
Senior Standing Counsel for  
Income Tax

For respondent

: Mr.Venkatnarayanan  
representing M/s.Subbaraya Iyer

JUDGMENT

(Judgment of the Court was delivered by CHITRA VENKATARAMAN,J.)

This appeal is by the Revenue on the following substantial questions of law:

- (i) Whether in the facts and circumstances of the case, the Tribunal was right in holding that the interest on the borrowed money utilised for the investment in shares cannot be set off against the dividend income under Section 80M of the Income Tax Act?



(ii) Whether in the facts and circumstances of the case, the Tribunal was right in granting investment allowance when it was never claimed at any earlier stage?

2. The assessee is a non banking finance company. In respect of the assessment year 1992-93, it declared a net income of Rs.22,89,090/-.

3. In the assessment for the assessment year 1992-93, the assessing authority worked out the relief under Section 80-M of the Act by making pro-rata allocation of the interest liability to funds invested in shares; thereby reduced the net dividend income available for deduction under Section 80-M of the Act.

4. The assessing officer viewed that the borrowed moneys were used in making investments in units and shares. He held that the notional amount relatable to such borrowing was treated as not relatable to business expenditure, but could be considered only with reference to income from other sources. Thus, the officer viewed that in the absence of any nexus shown in the investment between the borrowed money and the investment made in the units and shares, notional interest was attributed to the borrowed capital used for investments in interest share and thereby allocated it to the dividend income, the officer held that no portion of the interest on borrowed funds could be excluded while computing the income from business. Aggrieved of the same, the assessee filed an appeal before the Commissioner of Income Tax (Appeals). The Commissioner of Income Tax (Appeals) held that there was no proximate connection between the appellant's business interest, liability and investment of funds in shares. The appellate authority held that working out the notional interest and allocation it to the dividend income could not be accepted and it had the effect of unfairly reducing the appellant's eligible deduction under Section 80-M. The Appellate Authority, following the decision of the Gujarat High Court reported in 125 ITR 227 (ADDL. C.I.T. v. LAXMI AGENTS P. LTD) and 131 ITR 99 (CIT Vs. COTTON FABRICS LTD.), allowed the appeal, directing the assessing authority not to bifurcate the interest admissible under Section 36 (1)(iii) while computing the appellant's business income and the income from other sources and thus allowed the deduction under Section 80-M on the gross dividend without taking into account any such notional interest.

5. The Revenue preferred an appeal before the Appellate Tribunal challenging the view of the appellate authority that the borrowed funds were used in making investments in units and shares; hence, interest relatable to the borrowed capital could not be allowed in full that notional amount relating to such borrowing was to be treated as not relatable to business expenditure, but could



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be considered only with reference to income from other sources. The Tribunal noted that it had considered a similar claim of the assessee for the earlier assessment year 1989-90 and viewed that the investments were made only to obey the directions of the Reserve Bank of India. Accordingly, it came to the conclusion that the amount invested by the assessee would therefore form part of the business activity, and accordingly upheld the order of the Commissioner of Income Tax. Thus, the Tribunal dismissed the Revenue's appeal.

6. As regards the question of investment allowance, the Tribunal noted that for the immediate earlier year, it had allowed the claim, following the decision of the Supreme Court reported in 251 ITR 308 (CIT Vs. SHAAL FINANCE (P) LTD.) that if the lessee had carried on the manufacturing activity with the use of leased machinery, it would be in sufficient compliance of Section 32-A. Accordingly, the Tribunal allowed the relief.

7. Aggrieved by this view, the Revenue has preferred this appeal before this Court.

8. Learned Senior Standing Counsel appearing for the Revenue submitted that the grant of relief under Section 80-M on the view that the investments in units were made to obey the directions of the Reserve Bank of India would not make the interest on the borrowed capital, to be taken as business expenditure as the dividend from shares would fall for consideration as income from other sources. She further pointed out that the amendment introduced under Section 14-A of the Finance Act, 2001, is retrospective from 1.4.1962; hence no deduction could be allowed in respect of the expenditure referable to the income, which would not form part of the business income. On the question of investment allowance, the Revenue submitted that it was not an issue at all before the Commissioner of Income Tax (Appeals). Consequently, the Tribunal ought not to have granted the relief without seeing whether such a claim was part of the assessment considered.

9. Considering the decision reported in 155 ITR 120 (DISTRIBUTORS (BARODA) P. LTD. Vs. UNION OF INDIA (S.C.) and having regard to the provisions of Section 80AA, learned Standing counsel for Income Tax submitted that the Tribunal committed an error in its view that the interest on the borrowed money utilised for the investment in shares could not be disallowed against the dividend income under Section 80 M.

10. In the decision reported in 155 ITR 120 (DISTRIBUTORS (BARODA) P. LTD. Vs. UNION OF INDIA (S.C.), the Apex Court held that as far as Section 80-M(1) of the Income Tax Act is concerned, the deduction required to be allowed under that provision is liable



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to be calculated with reference to the amount of dividend computed in accordance with the provisions of the Act and forming part of the gross total income. The Apex Court further held that the relief granted under Section 80-M is with reference to the dividend computed in accordance with the provisions of the Act.

11. In the decision reported in 131 ITR 99 (CIT Vs. COTTON FABRICS LTD.), the Gujarat High Court dealt with the similar question where the assessee, a dealer in shares in the previous year, borrowed the amount which were used for the purpose of investment in shares. The deduction for the purpose of Section 80-M was to be on the basis of the computation done in accordance with the provisions of Sections 56 and 57 of the Act. The Gujarat High Court in 131 ITR 99 (C.I.T. v. COTTON FABRICS LTD) at 104 held that,

"..... Under section 36 of the IT Act, the interest paid by an assessee for the purpose of carrying on its business is deducted in its entirety while computing profits and gains of the business and, therefore, it is not possible to allocate a portion of that interest as against income from dividends by stating that that interest had to be paid for the purpose of investing in shares held by the assessee"

The Gujarat High Court further held that,

".....when the income from other sources is computed in accordance with the provisions of Sections 56 and 57, there is no deduction to be made by way of interest paid in respect of the income from the dividends because the interest is paid by the assessee company for the purpose of carrying on its business and the entire interest is deductible under Section 36(1)(iii) of the Act. Therefore, the entire amount of dividend, call it gross or call it gross minus nil, will be the amount with reference to which the relief under Section 80 M will have to be computed."

The Gujarat High Court further held that the borrowing was for the purpose of business of the company. Consequently, the interest cannot be apportioned as between the business requirements and the monies borrowed for the purpose of investment in shares. The Gujarat High Court further held that no apportionment is possible when the shares held by the assessee are for the purpose of business and was assessable as such on profits and gains of business carried on by the assessee.

12. Learned counsel appearing for the respondent submitted that the investment in units and shares were made only to comply with the directions of the Reserve Bank of India. Once it was established that the amount principally borrowed was for a business



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purpose and the interest on borrowed capital was considered for deduction under Section 36(1)(iii) then it is not possible to bifurcate that interest for the purpose of working out the relief under Section 80-M. Hence, it being part of the business activity, the deduction was rightly allowed after deducting the interest on the borrowed funds under Section 36(1)(iii). Hence he prayed that the decision of the tribunal is in accordance with law and be accepted.

13. It may be noted that no material is placed before this Court as regards the contention that the investment made were out of pure business compulsion to comply with the directions of the Reserve Bank of India. Except for a mere assertion and there being no details to support this contention with the necessary direction of the Reserve Bank of India, we do not accept this plea of the learned counsel for the respondent. The investments were admittedly out of the funds borrowed for business purposes. The amount eligible for deduction under Chapter VI is only the net amount after the deduction of the expenses. The deduction under Section 80-M has to be with reference to the amount of dividend computed in accordance with the provisions of the Act forming part of the gross total income, i.e., after deducting the interest paid on the money borrowed for earning that income and interest with reference to the gross dividend received by the assessee. In the case on hand, there are no materials to hold that the dividend income was earned on an incidence to the business income. The facts in the decision of the Gujarat High Court reported in 131 ITR 99 (CIT Vs. COTTON FABRICS LTD.) is totally distinguishable from the facts of the present case. In fact, the view of the Gujarat High Court has not been accepted by this Court in the decision reported in 249 ITR 540 (COMMISSIONER OF INCOME TAX Vs. CHEMICAL HOLDINGS LTD.). The decision of the Apex Court reported in 155 ITR 120 (DISTRIBUTORS (BARODA) P. LTD. Vs. UNION OF INDIA (S.C.) fully cover the issue in that, the deduction under Section 80-M(1) has to be calculated with reference to the amount of dividend comprised in accordance with the provisions of the Act forming part of the gross total income i.e., after deducting the interest paid on the monies borrowed for earning such income and not with reference to the gross dividend received.

14. Dealing with the question of deduction of interest on the money borrowed for investment in shares, this Court considered the question of interest deduction in the computation of the dividend that goes for consideration under Section 80-M. In the decision reported in 249 ITR 540 (COMMISSIONER OF INCOME TAX Vs. CHEMICAL HOLDINGS LTD.), while considering the said question, this Court held as follows:



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" The income from dividend is regarded as income from other sources and forms a different head of income. This head of income is different from the head "profits and gains of business or profession". Where an assessee has income from other sources such as dividends, and also has income from the business or profession, and the deduction allowable under the respective heads is to be made in relation to the income realised under those heads, the expenditure laid out exclusively for the purpose of earning dividend income cannot, for the purpose of claiming a larger benefit under section 80M, be ignored and that amount excluded under section 37(3) in cases where an assessee has income from dividends as also from business, although section 37 provides for the deduction of the amount of interest paid in respect of the capital borrowed for the purpose of business or profession. To the extent the interest charged is capable of being regarded as expenditure laid out or expended wholly and exclusively for the purpose of making or earning dividend income, the interest so paid must be deducted under section 57(iii) before computing the benefit under section 80M. "

15. This Court further pointed out that dividend could have been earned only after investments were made. The net dividend has to be calculated after deducting the expenditure as provided for under Section 57. This Court dissented the view expressed in the decision reported in [1981] 131 ITR 99 (Guj.), (CIT Vs. COTTON FABRICS LTD.) by the Gujarat High Court, taking the view that there could not be an allocation of interest as against the income from dividend where the borrowing was for business purpose, the interest paid being a business expenditure qualified for deduction under Section 37. In the light of the said decision of this Court referred to above, we do not agree with the reasoning of the order of the Tribunal.

16. The computation insofar as dividend are concerned is to be made in accordance with Section 57. Clause (i) of Section 57 states that in the case of dividends or interest on securities, the sum paid by way of commission or remuneration of a banker or any other person for the purpose of realising the dividend or interest to be deducted. Apart from this, any other expenditure not being in the nature of a capital expenditure laid out or expended wholly and exclusively for the purpose of making or earning dividend income is also deducted as per Section 57(iii). Considering the



above-said provision, all that it goes for deduction is not the gross dividend but a net dividend arrived at in terms of the provisions given therein.

17. We hold that in the light of the decision of the Supreme Court reported in 155 ITR 120 (DISTRIBUTORS (BARODA) P. LTD. Vs. UNION OF INDIA (S.C.) and this Court in the decision reported in 249 ITR 540 (COMMISSIONER OF INCOME TAX Vs. CHEMICAL HOLDINGS LTD.), net dividend alone can be taken in for consideration under Section 80-M Where the assessee does not prove the actual expenditure incurred and the money borrowed for business purposes has been diverted for purchase of shares and units, certainly, the amount of interest relating to the amount used for the purpose of investment has to be taken in for the purpose of working out the net deduction under Section 80-M.

18. Learned standing counsel referred to the amendment brought forth by introducing Section 14-A by the Finance Act, 2001. We do not find any relevance of this provision to the issue on hand.

19. It may be noted that the computation for the purpose of deduction under Section 80-M is required to be made in accordance with Section 80-AA, which provides that before allowing deduction under Section 80-M, computation of income by way of dividend be first made in accordance with the provisions of the Act. The computation as regards dividend income is to be made in accordance with Section 56 and 57.

20. Under similar circumstances, the Bombay High Court, in the decision reported in 236 ITR 456 (C.I.T. Vs. MAGAN CHHAGANLAL (P.) LTD.), applying the decision of the Apex Court reported in 155 ITR 120 (DISTRIBUTORS (BARODA) P. LTD. Vs. UNION OF INDIA (S.C.)), held that where the main business of the assessee was not of dealing in shares and stocks but were engaged in the business of manufacture of drums and barrels, the assessee would be entitled to a deduction of interest proportionate to the capital investment on shares on the dividend earned to earn the relief under Section Section 80-M.

21. In the circumstances, we allow the appeal of the Revenue and set aside the order of the Tribunal.

Sd/-  
Asst. Registrar.

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Sub Asst. Registrar.

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To:

1. The Commissioner of Income Tax  
Madurai.

2. The Assistant Registrar  
Income Tax Appellate Tribunal  
III Floor, Rajaji Bhavan, Besant Nagar,  
Chennai-90.

3. The Commissioner of Income Tax (Appeals-1) Madurai

4. The Income Tax Appellate Tribunal  
Bench A, Madurai.

5. The Deputy Commissioner of Income Tax,  
Special Range I, Madurai.

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